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In The

Supreme Court of the United States

October Term, 1997

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Petitioner,

v.

203 NORTH LASALLE STREET PARTNERSHIP,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

JOINT BRIEF OF AMICI CURIAE IN SUPPORT OF THE RESPONDENT

(Organizations Listed on Inside Cover)

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I.
INTERESTS OF *AMICI CURIAE*[1]

The Credit Associations,[2] National Small Business United ("NSBU"), the National Apartment Association ("NAA"), and the Commercial Investment Real Estate Institute ("CIREI") file this brief as *amici curiae* in support of Respondent 203 North LaSalle Street Partnership ("LaSalle"). The parties have consented to the filing of this Brief, and their written consent is filed together with this Brief.

The Credit Associations consist of twenty-one regional associations of businesses that extend commercial credit. They have in the aggregate over 15,600 members, serve a diverse spectrum of industry credit groups, and generally represent the interests of unsecured creditors. When a business debtor finds itself in financial trouble, members of the Credit Associations and other similar businesses often make up a significant component of the debtor's unsecured creditors.

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[1] This Brief was authored by counsel for *amici curiae*. No entity other than *amici curiae* and their counsel made any monetary contribution to its preparation or submission.

[2] The Credit Associations are Credit Managers Association of California; Georgia Association of Credit Management d/b/a NACM-Southeast Unit; Spokane Merchants Association d/b/a NACM Inland Northwest; Indiana Association of Credit Management; NACM Louisiana, Inc.; NACM-Carolinas, Inc.; NACM-Ohio; NACM South Central Region, Inc.; NACM of Florida, Inc.; NACM Oklahoma Division, Inc. d/b/a NACM Midamerica; NACM of Wisconsin, Inc.; NACM Mid-Atlantic Chapter, Inc.; NACM-Western Pennsylvania; NACM/Chicago Midwest; NACM-St. Louis; NACM Southwest; NACM of Arizona, Inc.; NACM-Great Lakes; NACM – Upstate New York; NACM East Tennessee, Inc.; and NACM – National Capital Region.

NSBU has been an advocate for small businesses since 1937. NSBU's more than 65,000 members through its chapters and affiliates include carpenters, consultants, manufacturers, retailers, grocers, designers, and other small businesses that comprise the backbone of the American economy. NSBU is a non-partisan advocacy group that constructively engages its members in legislative and regulatory initiatives that affect the small business community.

NAA is the nation's largest industry-wide, nonprofit trade association devoted solely to the needs of the apartment industry. NAA represents approximately 26,000 owners, builders, investors, developers, managers, and other rental housing professionals who hold responsibility for more than 3.4 million apartment households nationwide.

CIREI is affiliated with the National Association of Realtors and is dedicated to education and excellence in the commercial real estate profession. Its membership consists of approximately 6,000 brokers, bankers, consultants, property and asset managers, appraisers, investment counselors, attorneys, accountants, and other real estate professionals who serve the needs of commercial real estate owners, investors, and users.

Unsecured creditors, suppliers, small businesses, tenants, and real property managers and investors such as the members and clients of *amici curiae* benefit from the successful reorganization of a financially troubled debtor. A successful reorganization typically increases the recovery on unsecured claims, facilitates investments of new capital improvements into the debtor and its assets, and preserves a source of business for the debtor's creditor-suppliers. A successful reorganization also helps preserve jobs for the employees of both debtors and their suppliers.

Amici curiae recognize that the ability of a financially troubled debtor to reorganize often depends on its ability to raise new capital, either to help satisfy creditor claims or to provide working capital for the reorganized enterprise. The holders of existing equity (*i.e.*, current owners) may be the most likely and logical, if not the only, source of such necessary new capital. Consequently, a principle of law that unduly curtails the availability of new capital for troubled businesses in the context of "new value" plans of reorganization would undermine the ability to reorganize such businesses and would make "distress sale" liquidations more likely.

The result that Petitioner Bank of America NT&SA ("Bank") seeks threatens just such an outcome, because it would prohibit the confirmation of a plan of reorganization based on a new capital infusion from existing equity owners whenever a single creditor class (or, as in this case, a single large creditor) votes to reject the plan, regardless of the wishes of the debtor's other creditors. To avoid this result, *amici curiae* support the decision of the Court of Appeals below and urge its affirmance.

II.

INTRODUCTION AND SUMMARY OF ARGUMENT

Bankruptcy Code[3] section 1129(b)(2)(B)(ii) provides that a plan of reorganization may be confirmed as "fair and equitable" even when a nonaccepting class of unsecured claims will not be satisfied in full, as long as the holders of junior equity interests do not receive or retain any property under the plan *"on account of such junior . . . interest[s]."* The Court of Appeals below held that when existing equity holders contribute new value

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[3] *See* 11 U.S.C. §§ 101-1330.

that is substantial and necessary to the reorganization, those equity holders may receive new equity in the reorganized debtor pursuant to a plan of reorganization, not "on account of" their existing junior equity interests, but rather "on account of" their new value contribution.

The decision of the Court of Appeals should be affirmed because it properly follows over a half-century of established case law and is consistent with the plain statutory language, the legislative history, and sound public policy.

1. By its plain language, Bankruptcy Code section 1129(b)(2)(B)(ii) only prohibits existing equity holders from receiving or retaining property *"on account of"* their *existing equity interests*. Nothing in the statutory language prohibits existing owners from receiving new equity under a plan "on account of" a *new capital investment* (rather than "on account of" their existing "junior . . . interest[s]"). Moreover, nothing in the Code otherwise prohibits existing owners from proposing or receiving value under a plan. *See* 11 U.S.C. §§ 1121(c), 1123(a)(5)(J). The plain language of the statute thus permits new value plans and should be dispositive. *See, e.g., Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 557-58 (1990).

2. The Bank proposes an overly broad interpretation of the phrase "on account of" that, contrary to its plain meaning, would bar existing equity holders from receiving any consideration under a new value plan whenever there may exist even the slightest, tangential connection between the equity holders' participation in the plan and their existing equity interests. Brief of Petitioner ("Petr. Br.") at 21-22. In so doing, the Bank ignores this Court's interpretation of identical statutory language in *O'Gilvie v. United States*, 117 S. Ct. 452, 454-55 (1996), which held that the phrase "on account of" requires a "stronger

causal connection" than merely a " 'but-for' connection." Furthermore, the Bank's interpretation is inconsistent with the usage of the phrase "on account of" in other provisions of section 1129(b)(2) and throughout the Bankruptcy Code.

3. The Bank's interpretation of section 1129(b)(2)(B)(ii) would render the "on account of" language meaningless by effectively barring existing equity holders from ever participating in new value reorganizations. Congress certainly *could* have achieved this result by drafting section 1129(b)(2)(B)(ii) to provide that *"the holder of any interest that is junior to the claims of a nonconsenting senior class shall never receive or retain under the plan any property"*, thereby omitting any reference to the receipt or retention of property specifically *"on account of such junior . . . interest."* That is not, however, the statute Congress drafted. Rather, the simple, straightforward language of section 1129(b)(2)(B)(ii) only prohibits the holders of existing equity from receiving property "on account of" their existing equity interests; it does not prohibit existing equity holders from receiving property "on account of" something other than their equity such as a contribution of new value.

4. The Bank's contention that LaSalle's existing equity holders were improperly granted the "exclusive opportunity" to purchase equity in the reorganized debtor is equally unavailing. According to the Bank, this "opportunity" constituted an "exclusive option" that itself was "property" distributed "on account of" existing equity interests. However, the new value contribution under LaSalle's plan was not an *option*, but rather was an *obligation* that LaSalle's equity holders were *required* to fulfill in order for the plan to become effective. *See* Joint App. at 37 (the "partners *shall* make, or cause to be made, the capital contributions to the Reorganized Debtor")

(emphasis added). On the plan's effective date, all existing equity interests were cancelled, and the only "property" that the contributing equity holders received under the plan was the new equity interests obtained on account of their new value contributions.

5. The Bank concedes that new value plans may be proper as long as both creditors and equity holders are allowed to participate in an "open auction" to contribute new value. Petr. Br. at 11 n.6. In so conceding, the Bank distinguishes between those new value plans in which existing equity holders are the exclusive source of new capital versus those in which creditors may also contribute new capital. The Bankruptcy Code, however, does not support such a distinction. If, as the Bank concedes, equity holders may contribute new value on a nonexclusive basis, nothing in the Bankruptcy Code prohibits equity holders from so contributing on an exclusive basis. In either case, the "property" the equity holders receive in the form of new equity in the reorganized debtor is "on account of" their new value contribution, whether nonexclusive or exclusive, and not "on account of" their existing equity holdings.

6. To the extent that the phrase "on account of" may be ambiguous, *see O'Gilvie*, 117 S. Ct. at 454 ("the phrase 'on account of' does not unambiguously define itself"), this Court should look to bankruptcy law as it existed prior to the Bankruptcy Code's enactment, *see Dewsnup v. Timm*, 502 U.S. 410, 419-20 (1992). Contrary to the Bank's assertion, the new value principle was not *"dicta"* prior to the Code's enactment. A half-century of prior case law applying the "fair and equitable" requirement clearly established that equity holders of an insolvent debtor could receive equity interests in the reorganized debtor in exchange for a necessary contribution of new value, in

money or money's worth, that represented a fair equivalent for the equity that would be received under the plan. *See, e.g., Mason v. Paradise Irrigation Dist.*, 326 U.S. 536, 541-42 (1946); *Consolidated Rock Prods. v. Du Bois*, 312 U.S. 510, 529 n.27, (1941); *Case v. Los Angeles Lumber Prods.*, 308 U.S. 106, 121-22 (1939).

7. When Congress intends for legislation to change existing law, it must make that intent specific. *See, e.g., Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection*, 474 U.S. 494, 501 (1986). Here, the statutory codification of the "fair and equitable" requirement in section 1129(b) fails to evince any congressional intent to abrogate the "new value" principle; rather, that language only prohibits the holder of a junior interest from receiving property "on account of such junior . . . interest," not from receiving property "on account of" a new capital contribution. Moreover, the statute explicitly uses "words of art" from the former Bankruptcy Act – "fair and equitable" – which were interpreted to include the "new value" principle. *See Case*, 308 U.S. at 121-22.

8. Similarly, nothing in the voluminous legislative history of the Bankruptcy Code suggests that Congress intended to rip the "new value" principle from the fabric of reorganization precedent. Although Congress did reject an effort to dilute the requirements that had to be satisfied in order to invoke the new value principle (and thus Congress' attention was directed to that principle), the legislative history reflects no intention to abrogate the new value principle. *See In re Snyder*, 967 F.2d 1126, 1129-30 (7th Cir. 1992) (containing extensive discussion of legislative history).

9. The "new value" principle fosters Congress' policy of rehabilitation that underlies chapter 11 reorganizations by encouraging the infusion of new equity capital into chapter 11 debtors. "[T]he policy of Chapter 11 is to

permit successful rehabilitation of debtors . . . . " *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 527 (1984). "By permitting reorganization, Congress anticipated that the business would continue to provide jobs, to satisfy creditors' claims, and to produce a return to its owners. Congress presumed that the assets of the debtor would be more valuable if used in a rehabilitated business than if 'sold for scrap.' " *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983) (citations omitted). A *per se* rule prohibiting new value plans, however, would prevent reorganizations in the substantial number of cases in which the availability of a new capital infusion from existing owners is of critical importance.

III.

ARGUMENT

A. The Statutory Codification Of The "Fair And Equitable" Requirement Does Not Prohibit "New Value" Plans.

1. The Statutory Context Of Plan Confirmation.

Bankruptcy Code section 1129(a) sets forth thirteen separate requirements that must be satisfied in order to confirm a chapter 11 plan. Included among these requirements is that each impaired class of claims or interests must have "accepted" the plan. 11 U.S.C. § 1129(a)(8).[4] A class of creditors "accepts" a plan if the plan is accepted by creditors holding a majority in number *and* two-thirds in amount of the allowed claims in the class that actually vote on the plan. 11 U.S.C. § 1126(c). Thus, a group of

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[4] Generally, a class is "impaired," and its acceptance therefore required under section 1129(a)(8), if its legal, equitable, or contractual rights are altered by the plan. *See* 11 U.S.C. § 1124.

creditors (or even a single large dissenting creditor) that holds more than one-third of the claims in a creditor class can prevent acceptance of the plan by that class, even if a majority of the members holding a majority of the claims in the class vote to accept the plan.

Even if one or more impaired creditor classes do not accept the plan, however, the plan nonetheless may be confirmed under certain statutorily prescribed circumstances. If the plan satisfies all of the confirmation requirements other than the voting requirement, the court "*shall confirm* the plan notwithstanding the requirement of [section 1129(a)(8)] if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1) (emphasis added). Thus, in order to foster the chapter 11 goal of reorganization, Congress determined that even if a holdout class (or a large holdout creditor who can veto class acceptance) does not accept a plan, the plan *shall* still be confirmed if, among other things, it is fair and equitable to a nonconsenting creditor class.

2. The Plain Language Of Section 1129(b)(2)(B)(ii) Is Dispositive And Does Not Prohibit Equity Holders From Receiving New Equity Under A Plan In Exchange For A New Capital Contribution.

The meaning of the statutory codification of the "fair and equitable" requirement "begins with the language of the statute itself." *Davenport*, 495 U.S. at 557-58. Where, as here, the language of the statute is plain, this is also where the inquiry should end. *United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989) ("the sole function of the courts is to enforce [the statute] according to its terms") (quotation omitted).

Section 1129(b)(2)(B)(ii) provides that a plan may be "fair and equitable" with respect to a dissenting class of unsecured claims if:

> the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan *on account of such junior claim or interest* any property (emphasis added).

By its plain terms, section 1129(b)(2)(B)(ii) does not impose a *per se* prohibition against economic participation by exisiting equity in the reorganized debtor; instead, it prohibits such participation only when it is *"on account of such junior claim or interest."*

The insertion of this limiting language makes it clear that Congress did not intend to preclude existing equity holders from participating as new equity holders in the reorganized debtor on account of a new capital contribution:

> Had Congress intended that old equity never receive any property under a reorganization plan where senior claim classes are not paid in full, it could simply have omitted the "on account of" language from section 1129(b)(2)(B)(ii). We would then be left with an absolute prohibition against former equity owners receiving or retaining property in the reorganized debtor in such circumstances. The expansive reading of the phrase "on account of such junior claim or interest" suggested by [the Bank] would lead to the identical result, thus rendering the disputed phrase superfluous. . . . Congress must have intended the "on account of" language to have some significant meaning as well as some particular limiting effect.

In re Bonner Mall Partnership, 2 F.3d 899, 909 (9th Cir. 1993), *cert. dismissed*, 513 U.S. 18 (1994).

"[A] statute must, if possible, be construed in such fashion that every word has some operative effect."

United States v. Nordic Village, Inc., 503 U.S. 30, 36 (1992). The Bank, however, advocates such an expansive reading of "on account of" as to render the phrase meaningless. According to the Bank, as long as there is *any* conceivable relationship between the equity holders' existing interests and the interests they will receive in exchange for new value, then the new value plan fails the "fair and equitable" test. Petr. Br. at 21-22. Since one of the reasons that existing equity holders often desire to participate in new value plans is because of their long-standing knowledge of and relationship with the debtor, the Bank's expansive definition would effectively bar equity holders from ever participating in such plans. By its very terms, however, section 1129(b)(2)(B)(ii) clearly contemplates the possibility of existing equity holders participating in at least some reorganization plans even when a nonassenting senior class is not satisfied in full, as long as those holders do not receive or retain any consideration "on account of" their existing equity interests.

This Court recently resolved conflicting interpretations of the statutory phrase "on account of" by rejecting an expansive interpretation such as that offered by the Bank in favor of a strict, causal meaning. *See O'Gilvie*, 117 S. Ct. at 453-54. In *O'Gilvie*, taxpayers contended that punitive damage awards were not taxable under a statute exempting from federal income tax any "damages received . . . on account of personal injuries or sickness." 26 U.S.C. § 104(a)(2). According to the taxpayers, the punitive damages were tax exempt since they were awarded because of (and thus, they contended, "on account of") their personal injuries.

In rejecting the taxpayers' argument, the Court held that although it was true that the taxpayers would not have received punitive damage awards "but for" their injuries, this indirect causal connection was insufficient to

make the awards "on account of" their injuries. While recognizing that "the phrase 'on account of' does not unambiguously define itself", 117 S. Ct. at 454, the Court held that the "interpretation [that] gives the phrase 'on account of' a meaning consistent with the dictionary definition" is one that "impose[s] a stronger causal connection" that is "more than a 'but-for' connection," *id.* at 454-55.[5] Rather, in order for damages to be "on account of" a personal injury, they must be those actual damages that arose "by reason of" or "for the sake of" that injury. *Id.* at 455.

Under a new value plan, the reason that existing equity holders may receive equity in the reorganized debtor is for the sake of (and thus "on account of") their contribution of necessary and substantial new capital. Although the equity holders might have had no desire to contribute new value "but for" their prior equity holdings, following *O'Gilvie* the mere fact that a prior equity holder participates in a new value plan does not make such participation "on account of" the holder's existing equity interests.

An interpretation of "on account of" that requires a close causal connection is consistent with the use of that phrase in other provisions of Bankruptcy Code section 1129, as well as other sections of the Bankruptcy Code.

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[5] The Solicitor General argued to this Court in *O'Gilvie* "the fact that personal injury is a prerequisite to punitive damages does not lead to the conclusion that the punitive damages were 'on account of' the plaintiff's injuries." 1996 W.L. 325323 at 14. Applying this reasoning, the fact that a plan provides that holding an existing ownership interest may be prerequisite to contributing new value does not lead to the conclusion that the new equity in the reorganized debtor obtained in exchange for that new value was "on account of" the existing ownership interest.

The phrase "on account of" occurs *eight* separate times in section 1129, specifically in subsection (b)(2)(B)(ii), which is at issue here, subsection (b)(2)(C)(ii), which provides analogous protections for classes of senior equity interests, and in six provisions that specifically authorize or require various types of distributions to creditors and equity holders "on account of" their existing claims and interests, specifically subsections (a)(7)(A)(ii), (a)(7)(B), (a)(9)(c), (b)(2)(A)(i)(II), (b)(2)(B)(i), and (b)(2)(C)(i). The *only* logical meaning of "on account of" that could apply uniformly in each of these eight instances is "in consideration of" or "for the sake of", and not simply "but for." *See Cohen v. De la Cruz*, 118 S. Ct. 1212, 1217 (1998) (applying "the presumption that equivalent words have equivalent meaning when repeated in the same statute" to Bankruptcy Code). This is also the most widely accepted meaning given to the phrase "on account of" throughout the Bankruptcy Code. *See, e.g., In re El Paso Refinery, L.P.*, 178 B.R. 426, 449 (Bankr. W.D. Tex. 1995) ("The phrase 'on account of' [as used in Bankruptcy Code section 547(b)] carries with it the connotation of causation."); *In re Evenson*, 165 B.R. 27, 28 (Bankr. E.D. Mich. 1994) (" 'on account of' [as used in section 522(d)(10)(E)] refers to payment rights which are 'triggered by' the events listed in the statute"); *In re Bioplasty, Inc.*, 155 B.R. 495, 498 (Bankr. D. Minn. 1993) ("on account of" means "as compensation for" in section 547(b)).

B. The "New Value" Principle Was Recognized In Pre-Code Case Law Construing The "Fair And Equitable" Requirement And Was Not Abrogated By The Code.

1. The Recognition Of The New Value Principle As A Corollary To The "Fair And Equitable" Requirement Under The Former Bankruptcy Act.

Were this Court to find that "the phrase 'on account of' does not unambiguously define itself" in the context

of section 1129(b)(2), *see O'Gilvie*, 117 S. Ct. at 454, it should then turn to precedents decided under the former Bankruptcy Act for guidance, *see Dewsnup*, 502 U.S. at 419-20; *Davenport*, 495 U.S. at 563. These precedents, which include at least five separate decisions of this Court, unquestionably established the existence of the new value principle under the Act.

As in the current Bankruptcy Code, the reorganization provisions of the prior Bankruptcy Act included the "fair and equitable" requirement.[6] Although the "fair and equitable" requirement was not defined in the prior statute, courts interpreted that requirement to incorporate the so-called "absolute priority" rule, which provided that creditors of a debtor were entitled to priority in consideration of their claims over the rights of stockholders in consideration of their junior equity interests. *See Kansas City Terminal Ry. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926).

Because the "absolute priority" rule provided that creditors were to be compensated for their claims to the debtor's enterprise value before equity could participate in that value on account of their equity interests, there was nothing in that rule, *per se*, that prohibited equity holders from buying ownership interests in the reorganized debtor in exchange for a contribution of fresh capital. Consequently, at the same time this Court was articulating and developing the "absolute priority" rule, the Court also recognized that this rule did not prevent existing equity holders from acquiring new equity in the

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[6] When Congress enacted the reorganization provisions of section 77B and, thereafter, Chapter X of the former Bankruptcy Act in the 1930's, it included the statutory requirement that a plan be "fair and equitable." *See* Bankruptcy Act § 221(2), codified in former 11 U.S.C. § 621(2) (repealed 1978).

reorganized debtor in exchange for a new capital contribution as long as the fresh capital met certain requirements that were designed to ensure that existing values were not being diverted from creditors to equity holders:

> It has long been recognized in reorganization law that those who put new money into the distressed enterprise may be given a participation in the reorganization plan reasonably equivalent to their contribution. That rule is based on practical necessities. Without the inducement new money could not be obtained.

Mason, 326 U.S. at 541-42 (citation omitted).

This Court made clear no less than five separate times that, by the mid-1940's, it viewed the new value principle as part of the fabric of reorganization practice. *See Case*, 308 U.S. at 117, 121-22; *Consolidated Rock Prods.*, 312 U.S. at 529 n.27; *Marine Harbor Properties v. Manufacturer's Trust Co.*, 317 U.S. 78, 85 (1942) (discussing new value principle as the "rule" of *Case*); *Ecker v. Western Pac. R.R.*, 318 U.S. 448, 486-87 (1943) (applying new value principle to affirm confirmation of plan that provided enhanced treatment for creditor that contributed new value); *Mason*, 326 U.S. at 541-43.

The Court's repeated recognition of the new value principle was based upon the practical need for new funds in a reorganization case and the fact that existing equity holders often are the most logical source of such funds:

> Generally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them, unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them.

Kansas City Terminal Ry., 271 U.S. at 455.

The Bank attempts to dismiss this Court's repeated recognition of the new value principle as "mere *dicta*". *See*

Petr. Br. at 33-34. To the contrary, at least in *Case*, this Court's detailed consideration of the limits of the new value principle was essential to the outcome.[7] The plan in *Case* proposed that existing stockholders would receive approximately 23% of the equity in the reorganized debtor in recognition of, among other things, the value the stockholders provided in terms of " 'their familiarity with the operation' of the business and their 'financial standing and influence in the community.' " 308 U.S. at 112. This Court recognized the new value principle, but found that this proposed "contribution" flunked the new value principle's requirements because it could not "be translated into money's worth reasonably equivalent to the participation accorded the old stockholders." *Id.* at 122.[8]

Moreover, it is clear that the lower courts routinely treated this Court as having established the rule of the new value principle. *See, e.g., In re King Resources Co.*, 651 F.2d 1326, 1339 (10th Cir. 1980) (Bankruptcy Act case holding that "[u]nder certain circumstances stockholders may participate in a plan of reorganization of an insolvent debtor, but only if they make a fresh contribution of

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[7] *"Dictum"* is commonly defined as "an opinion concerning some rule of law or legal proposition not necessarily involved nor essential to determination of the case in hand." *Blacks Law Dictionary* 454 (6th ed. 1990). Under this standard, the principles articulated in *Case* must not be regarded as *dicta*, because there would have been no need for the Court in *Case* to address the issue of why the plan failed to satisfy the new value participation test unless the Court first *held* that the new value principle exists and that the absolute priority rule did not, *per se*, prohibit such participation.

[8] Although this Court subsequently did refer to the new value discussion in *Case* as *"dicta"* in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 205 (1988) (the reference itself arguably in *dicta*), the Court did not explain the basis of its characterization.

money or money's worth"); *In re Four Seasons Nursing Centers*, 472 F.2d 747, 750 (10th Cir. 1973) (shareholders of insolvent debtor must "introduce[ ] fresh money" in order to participate in plan); *In re Muskegon Motor Specialties*, 366 F.2d 522, 525 (6th Cir. 1966) ("if the corporation is insolvent, . . . then there is no room in the new corporation for old shareholders unless they contribute fresh capital"); *Mecca Temple v. Darrock*, 142 F.2d 869, 872 (2d Cir. 1944) (stockholders of insolvent debtor may participate in plan by providing "some fair compensating advantage" to creditors); *Metropolitan Holding Co. v. Weadock*, 113 F.2d 207, 209 (6th Cir. 1940) (affirming denial of confirmation in an insolvent case because the stockholders did not "contribute the reasonable equivalent in money or money's worth"). Leading commentators also recognized the new value principle as existing prior to the Bankruptcy Code's enactment. *See* 6A *Collier on Bankruptcy* ¶ 11.06 at 229-31 (14th ed. rev. 1977) (discussing new value principle and cases recognizing it); 4 *Norton Bankruptcy Law & Practice* § 93:13 at 93-46 n.36 (2d ed. 1993) (rejecting argument that new value principle was mere *dicta* under the Bankruptcy Act).

Finally, contrary to the Bank's assertion, reported decisions *did* confirm new value plans in which shareholders received equity prior to the current Code's enactment. *See, e.g., In re Universal Lubricating Sys.*, 59 F. Supp. 171, 172 (W.D. Pa.) (after plan that allowed shareholders to participate was rejected as not fair and equitable, court confirmed amended plan that allowed equity holders to participate by contributing new value), *aff'd* 150 F.2d 832 (3d Cir. 1945); *In re Donahoe's, Inc.*, 19 F. Supp. 441 (D. Del. 1937) (confirming plan that authorized common shareholders to receive equity on account of new value over the objection of senior preferred shareholders). The Bank's claim that it cannot find any more such reported

decisions is no indication that courts did not approve new value plans. Rather, it reflects the fact that the new value principle was so well established by the mid-1940's as to not justify further reported decisions.

2. The Codification Of The "Fair And Equitable" Requirement In The Bankruptcy Code Did Not Abrogate The New Value Principle.

a. The Code Should Not Be Read To Abrogate The Pre-Code Interpretation Of The "Fair And Equitable" Requirement, Absent Clear Evidence Of A Contrary Intent By Congress.

In light of the pre-Code case law that interpreted the "fair and equitable" requirement to permit the continued participation by existing equity in a reorganized debtor in exchange for a necessary and substantial new capital contribution, there is no basis for reading into the current statutory codification of the "fair and equitable" requirement a *per se* prohibition on "new value" plans that is not found in the plain language of the statute itself. "We will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Davenport*, 495 U.S. at 563; *see also De la Cruz*, 118 S. Ct. at 1218. "[I]f Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. The Court has followed this rule with particular care in construing the scope of bankruptcy codifications." *Midlantic*, 474 U.S. at 501 (citation omitted)[9]. "[T]his Court has been reluctant to

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[9] The pre-Code case law that addressed the new value principle provides a far firmer basis for finding a settled pre-Code judicial interpretation than did the pre-Code precedent relied on by the Court in *Midlantic*. In *Midlantic*, the Court found sufficient evidence of the establishment of a judicially

accept arguments that would interpret the [Bankruptcy] Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Dewsnup*, 502 U.S. at 419.

The words "fair and equitable" as used in section 1129(b)(2) were "words of art" under the Bankruptcy Act. *Securities & Exch. Comm'n v. American Trailer Rentals Co.*, 379 U.S. 594, 611 (1965). Prior to the enactment of the current Bankruptcy Code, the phrase already "had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations." *Case*, 308 U.S. at 115. Congress clearly knew that the meaning included the new value principle, yet evinced no indication to change it. Accordingly, this Court should presume that Congress intended the Bankruptcy Code to incorporate all aspects of pre-Code "fair and equitable" jurisprudence, including the ability of existing equity holders to contribute new value in exchange for equity in the reorganized debtor.

b. The Legislative History Of The Code Manifests No Intent To Eliminate The New Value Principle.

"[T]here is nothing in the legislative history of the 1978 Code or in the language of section 1129(b)(2) suggesting that Congress intended to modify past judicial interpretation of the absolute priority doctrine or its new

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developed pre-Code principle in two court of appeals decisions and one bankruptcy court decision. No decision of the Court was cited as proof that the pre-Code principle existed. *See* 474 U.S. at 500-01; *see also* 474 U.S. at 512 (Rehnquist, J., dissenting). The prior statements of this Court regarding the new value principle provide a far more compelling basis for finding an established pre-Code practice than existed in *Midlantic*.

value [corollary]." *In re SLC Ltd., V,* 137 B.R. 847, 853 (Bankr. D. Utah 1992) (citations omitted). Indeed, the *only* reference to the new value principle found in the legislative history consists of a proposal to *relax* the principle's requirements and make new value plans *easier* to confirm, which Congress rejected. Early in the legislative process, the Bankruptcy Commission proposed to broaden the principle in order to permit contributions of value other than "money or money's worth" to suffice as new value. Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d Cong., 1st Sess., pt. I, 258-59; Pt. II, §§ 7-303(4) & (7), 7-310 (1973). Congress rejected that proposal, thereby evincing an intent not to *dilute* the established requirements of the new value principle. Even though Congress' attention was thus clearly drawn to the new value principle,[10] Congress took no action to narrow or limit its availability. *See In re Snyder*, 967 F.2d at 1129-30.[11]

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[10] The House Committee on the Judiciary prepared a chart comparing the Commission's proposal to prior law and noted that "[t]his 'future contribution' doctrine sharply departs from the absolute priority rule of § 221(2) of the Bankruptcy Act. The Supreme Court decision in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), is overruled." Hearings on H.R. 31 & 32 Before the Subcomm. on Civil & Constitutional Rights of the House Comm. on the Judiciary, 94th Cong., 1st & 2d Sess., Ser. 27, App. 248 (1975) (relevant portions set forth in Appendix hereto).

[11] Ironically, some critics of the new value principle claim to derive support from Congress' rejection of the Bankruptcy Commission's proposal to dilute that principle. *See Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1361-62 (7th Cir. 1990). This seems to be an odd use of legislative history; the fact that a diluted version of a principle is rejected does not indicate Congressional intent to reject the principle itself, especially where, as here, Congress' attention was drawn to the principle, and Congress did nothing to eliminate it.

c. The Absence Of An Express New Value "Exception" In Section 1129(b) Of The Code Does Not Diminish The Vitality Of The New Value Principle.

The Bank argues that, because section 1129(b) does not include a statutory new value "exception" to the absolute priority rule, that "exception" did not survive the enactment of the Bankruptcy Code. *See* Petr. Br. at 18. The flaw in this search for a statutory new value "exception" is self evident; properly understood, the new value principle is not an exception at all, but is simply a corollary to the absolute priority rule. *See In re Snyder*, 967 F.2d at 1130. The receipt or retention of equity in the reorganized debtor by existing owners, in exchange for a new contribution of money or money's worth that is reasonably equivalent in value to the equity received or retained, simply does not violate the absolute priority rule in the first instance. Just as a plan could provide for the sale of equity in the reorganized debtor to a third party for fair consideration, the current owners, by paying that amount, may purchase or retain an equity interest. *In re Shepcaro*, 144 B.R. 3, 4 (Bankr. D. Mass. 1992).

Whatever the genesis of the phrase "new value exception," it cannot be traced to *Case* and the other pre-Code cases that addressed the new value principle. Those cases did not speak of an "exception" to the absolute priority rule, but rather addressed the circumstances under which the receipt of new equity in exchange for a new capital contribution would not violate that rule in the first instance.[12]

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[12] The first reference to a new value "exception" in any decision of this Court appeared ten years after the enactment of the Code, in *Ahlers*, 485 U.S. at 203-06. In *Ahlers*, however, the issue whether the new value principle was an "exception" to the

d. The Fact That The "Fair And Equitable" Requirement Now Applies To Dissenting Classes, Rather Than To Dissenting Creditors, Does Not Abrogate The Pre-Code Interpretation Of That Requirement.

The Bank argues that the new value principle did not survive the Bankruptcy Code's enactment because, according to the Bank, the Code altered the meaning of the phrase "fair and equitable." Petr. Br. at 37-38. Under Chapter X of the former Bankruptcy Act, a plan of reorganization could be confirmed only if it was "fair and equitable" for *each* dissenting creditor. *See* Bankruptcy Act § 221, former 11 U.S.C. § 621. Thus, under the prior law, the "fair and equitable" requirement applied even to a class that accepted the plan. Under Bankruptcy Code section 1129(b)(1), however, the "fair and equitable" requirement applies only where a class of claims rejects the plan and is not implicated where a class accepts the plan but contains dissenting creditors. Thus, the Bank argues, the application of the new value "exception" to the absolute priority rule against members of a rejecting class was not addressed in cases decided under the Bankruptcy Act.

The basic flaw in this theory is that, in specifying the requirements applicable to a dissenting class, Congress chose to use a phrase – "fair and equitable" – which the Court long ago referred to as "words of art which. . . . had acquired a fixed meaning." *Case*, 308 U.S. at 115. There is nothing in the legislative history of the Code that

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absolute priority rule was not the subject of any argument. The debtors themselves contended that their plan fell within an "exception" to the absolute priority rule, and no one challenged this characterization. *See id.* at 201-02 & n.2. Thus, the Court in *Ahlers* had no occasion to decide whether that characterization of the new value principle was accurate.

indicates that, in using this "term of art", Congress intended to change its settled meaning because it was being applied to a nonaccepting class, rather than to a nonaccepting creditor.

"[T]he settled rule [is] that, where provisions of a statute had previous to their re-enactment a settled significance, that meaning will continue to attach to them in the absence of plain implication to the contrary." *Heald v. District of Columbia*, 254 U.S. 20, 23 (1920); *see also Lorillard v. Pons*, 434 U.S. 575, 582 (1978) (where "Congress adopts a new law incorporating sections of a prior law, Congress normally can be presumed to have had knowledge of the interpretation given to the incorporated law, at least insofar as it affects the new statute"). Under this settled principle, the established meaning of the "fair and equitable" requirement would not change on the basis that it now applies to a dissenting class, rather than to a dissenting creditor.

C. The Fact That A Plan Provides For Existing Equity Holders Alone To Make The New Capital Contribution If The Plan Is Confirmed Does Not Result In The Receipt Of Any Property "On Account Of" An Existing Equity Interest In The Debtor.

Faced with (1) the fact that nothing in the plain language of section 1129(b)(2)(B)(ii) prevents a "new value" plan from satisfying the "fair and equitable" requirement, (2) the existence of the "new value" principle under pre-Code case law, and (3) the absence of any indication that Congress intended to abrogate that principle, the Bank focuses its challenge on the "exclusive opportunity" to buy new equity of the reorganized debtor which LaSalle's plan assertedly gave to existing equity holders. This challenge is predicated on the novel theory that a plan that gives existing equity holders alone the

opportunity to make a new capital contribution in exchange for an equity interest in the reorganized debtor gives such holders "property" on account of their junior equity interests. That "property", the argument goes, is not the equity in the reorganized debtor (which is paid for by the new contribution), but the so-called "exclusive right" to buy the new equity.

The Bank's argument ignores the fact that, under the plain terms of LaSalle's plan (like most new value plans), equity holders did not receive an *option* to obtain equity. Rather, for the plan to become effective, equity holders were *required* to contribute the requisite new value. *See* Joint App. at 37 (the "partners *shall* make, or cause to be made, the capital contributions to the Reorganized Debtor") (emphasis added). When the plan took effect, the only "property" that the existing equity holders received was the new equity interests obtained on account of their new value contributions.

Although section 1129(b)(2)(B)(ii) prohibits existing equity holders from receiving property on account of their existing junior interests, nothing in that statute or otherwise in the Bankruptcy Code prohibits equity holders from proposing or supporting a plan that requires their participation in the debtor's reorganization on account of something other than their existing equity, such as a new value contribution. To the contrary, the Code makes clear that equity security holders have the same right to propose, negotiate, object to, or support reorganization plans as do creditors. *See, e.g.*, 11 U.S.C. § 1121(c).[13]

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[13] Even during the period of plan exclusivity, the exclusive right to file a plan is a right that belongs to the *debtor* under the Code, and not to the debtor's equity holders. *See* 11 U.S.C. § 1121(a). This distinction is sharpened in many chapter 11 cases where the debtor is a publicly traded corporation.

Moreover, even if the Bank were correct that the existing equity holders' new value contribution was in fact an "option", the exclusivity of that so-called option in no way affected whether it was "property" distributed on account of existing equity interests. The "property" LaSalle's existing equity holders received was in exchange for their new value contribution, which the Bankruptcy Court determined was necessary and a fair equivalent of the equity received. The nature of the property they received would have been no different were creditors to have contributed new value for shares of new equity as well.

Because there exists no principled distinction between a new value plan under which only existing equity holders contribute new value and one under which creditors may make new value contributions as well, the only logical conclusion of the Bank's argument is that existing equity can *never* receive or retain any consideration under a new value plan. Yet, as set forth above, *see* 8-20 *supra*, the plain statutory language, legislative history, and pre-Code practice all preclude such a *per se* prohibition on equity holders receiving or retaining consideration under such a plan.

Bankruptcy Code section 1129(a)(11) *requires* that a plan be feasible in order to be confirmed. Thus, any plan that provides for the purchase of equity in the reorganized debtor in exchange for new capital must identify the source that will provide the new capital; otherwise, the plan would be built on thin air. A plan that identifies existing equity holders as the source of the new capital is no more objectionable than one that identifies creditors (or even a third party) as the source of the new capital. In either event, the plan does not allow any party to receive equity in the reorganized debtor on account of an existing

interest in the debtor, but rather only on account of a payment of new, necessary capital.

D. Policy Considerations Favor The Continued Vitality Of The New Value Principle.

In light of the plain statutory language and the ample pre-Code precedent recognizing the "new value" principle, it should be unnecessary to delve into the policy considerations that favor or disfavor the new value principle. To the extent that such policy considerations are relevant, however, they support reaffirmation of the new value principle.

This Court consistently has recognized "the congressional goal of encouraging reorganization." *Bildisco*, 465 U.S. at 527; *Whiting Pools*, 462 U.S. at 204. In pursuit of this goal, an infusion of new capital may be required for a successful reorganization. As a practical matter, the holders of existing equity may be the only realistic source of such new capital, especially in the case of a small or medium sized business that is financially troubled. Owners may have greater confidence than outsiders in the viability and future of a troubled business. They may have nonmonetary reasons to provide new value (such as having spent years building up a business or a real estate project) that would not be shared by others. There is no reason to deprive the reorganization process of what may be the most likely source of new capital, by adopting a *per se* rule that prohibits existing investors from buying back into the debtor in exchange for a fair and necessary capital infusion, whenever one class of creditors (which may consist of a single creditor such as the Bank) refuses to accept a plan that the majority of other creditors support.

The Bank contends that the new value principle is unnecessary because creditors supposedly will consent to

infusions of new value when it is in the best interests of the debtor's creditors and estate. Pet. Br. at 47. This contention ignores the possibility that a single class of creditors, or as here a single dissenting creditor, often may have its own agenda that does not include the reorganization of the debtor, even when reorganization is in the best interests of every other creditor constituency. *Cf. In re Snyder*, 967 F.2d at 1130 ("there are many reasons why creditors (often a single controlling creditor) withhold consent", citing example of a competitor of the debtor); *In re U.S. Truck Co.*, 800 F.2d 581, 587 (6th Cir. 1986) (recognizing that a union might vote to reject a plan "not because the plan is less than optimal to it as a creditor, but because the [union] has a noncreditor interest – *e.g.*, rejection will benefit its members in the ongoing employment relationship").

In this case, the Bank's real economic interest lies with respect to the plan's treatment of its *secured* claim, which treatment the lower courts unanimously found was fair and equitable because the plan pays the claim in full with interest. Yet, what is at issue here is the treatment of the Bank's *unsecured* deficiency claim – which nonrecourse claim would have been worthless were the Bank allowed to foreclose. By challenging the plan on the basis of its *unsecured* claim, the Bank is really attempting to leverage even better treatment for its own *secured* claim to the detriment of *all* of LaSalle's other unsecured creditors who support the plan and who will receive nothing if the Bank is allowed to foreclose.

There is of course nothing wrong with a creditor such as the Bank voting against confirmation of a plan to promote its own self interests. It is precisely because creditors do look out for their own self interests, however, that the Bankruptcy Code compels confirmation of a fair and equitable plan which otherwise satisfies the rigid

requirements of section 1129 notwithstanding the rejection of the plan by one or more classes of creditors.

Similarly, the Bank fails to address the phenomenon of cases involving numerous classes of creditors, where there is no value for a junior class of creditors under a new value plan or otherwise. Under the Bank's theory, a junior class of creditors for which there is no value (such as the holders of subordinated debt) could veto a "new value" plan, even if that plan was accepted by, and would be in the best interests of, the senior creditor classes. That is precisely the scenario that one court avoided by applying the new value principle. *See In re Resorts Int'l, Inc.*, 145 B.R. 412 (Bankr. D.N.J. 1990).[14]

The Bank contends that the new value principle enables old equity holders to repurchase an interest in the debtor at a bargain price, thereby diverting value within an insolvent estate from creditors to equity holders. The appropriate answer to this criticism is not the abrogation of the new value principle, but rather vigilance on the part of courts in requiring that the proponent of the plan affirmatively demonstrate compliance with each of the

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[14] The plan in *Resorts* was premised on the infusion of over $20 million in new and necessary operating capital by the existing equity holder in exchange for 21.5 percent ownership of the reorganized debtor. *Id.* at 434-35, 484. Creditor classes holding over $900 million in claims in the aggregate accepted the plan by overwhelming majorities. See *id.* at 429-31, 433. However, junior classes, consisting of disputed, securities-related litigation claims and other subordinated claims, rejected the plan. *See id.* at 430-31, 481. There was no value in the estate for these junior classes of claims, and the plan provided no distribution to these classes. *See id.* at 432, 478, 481-82. Under the Bank's theory, these junior, "out-of-the-money" classes could have vetoed the "new value" plan in *Resorts* unless they received "hold up" value. There is no principled bankruptcy policy that would support such a veto power.

requirements of that principle. First, the requirement that the contribution be in money or money's worth ensures that the contribution is actually of tangible value. Second, the requirement that the contribution be substantial and necessary means that the capital contribution must in fact promote the rehabilitative purposes of the Code – a purpose that is not served by small, unnecessary contributions. *See In re Snyder*, 967 F.2d at 1131. Third, the requirement that the new capital contribution must provide fair value for the equity interest that is received or retained prevents value from being unfairly diverted from the estate to the investor. *See In re Woodscape Ltd. Partnership*, 134 B.R. 165, 177 (Bankr. D. Md. 1991) (creditors must receive enterprise values that exist at confirmation determined before new investment is made).[15]

Finally, the Bank contends that the new value principle somehow reduces recoveries to creditors from the bankruptcy estate. The facts of this case belie the Bank's assertion. As noted, the courts below found that existing equity holders paid a fair price for the equity they purchased through their new value contribution under the plan. Solely because of the equity holders' new value contribution, LaSalle's plan was able to provide for the payment of the Bank's secured claim and all of the

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[15] The real protection afforded to creditors by these requirements is highlighted by the fact that courts have not hesitated to deny confirmation of plans that did not satisfy the requirements of the new value principle. *See, e.g., Carson Nugget, Inc. v. Green (In re Green)*, 98 B.R. 981, 982 (Bankr. 9th Cir. 1989); *In re Dowden*, 143 B.R. 388 (Bankr. W.D. La. 1989); *In re Tallahassee Assocs., L.P.*, 132 B.R. 712, 718 (Bankr. W.D. Pa. 1991); *In re Mortgage Inv. Co.*, 111 B.R. 604, 618-20 (Bankr. W.D. Tex. 1990); *In re Yasparro*, 100 B.R. 91, 98 (Bankr. M.D. Fla. 1989); *In re 47th and Belleview Partners*, 95 B.R. 117, 119 (Bankr. W.D. Mo. 1988); *In re Sawmill Hydraulics, Inc.*, 72 B.R. 454, 458 (Bankr. C.D. Ill. 1987).

estate's general unsecured creditors in full. The *only* unsatisfied creditors' claims were those of LaSalle's insiders (which were voluntarily waived) and the Bank's unsecured deficiency claim (for which the Bank would have received nothing were it allowed to foreclose). Application of the new value principle in this case thus enhanced recoveries to most of LaSalle's creditors, who would have received nothing in the event of the Bank's foreclosure, without in any way diminishing the Bank's recovery from the estate. For this reason, *amici curiae* strongly support the decision of the Court of Appeals below.

IV.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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APPENDIX

BANKRUPTCY ACT REVISION

HEARINGS
BEFORE THE
SUBCOMMITTEE ON CIVIL
AND CONSTITUTIONAL RIGHTS
OF THE
COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES
NINETY-FOURTH CONGRESS
FIRST AND SECOND SESSIONS
ON
H.R. 31 and H.R. 32
BANKRUPTCY ACT REVISION

Appendix

Serial No. 27

H.R. 31

SEC. 7-303. PROVISIONS OF PLAN. – A plan of reorganization –

* * *

(4) may provide, if the court finds that, (A) in the case of a partnership debtor, when the partners retain an interest under the plan, (B) in the case of an individual, when he retains an interest under the plan, and (C) in the case of a corporate debtor, when the equity security holders retain an interest under the plan, the individual debtor, certain partners or equity security holders will make a contribution which is important to the operation of the reorganized debtor or the successor under the plan, for participation by the individual debtor, such partners, or such holders under the plan on a basis which reasonably approximates the value, if any, of their interests, and the additional estimated value of such contribution;

H.R. 32

PART 3. PROVISIONS RELATING TO PLAN

SEC. 7-301. PROVISIONS OF PLAN. – A plan of reorganization –

* * *

(4) may provide for equity security holders to retain an interest under the plan, if the court finds the equity security holders will make a contribution which is important to the operation of the reorganized debtor or the successor under the plan, for participation by such holders under the plan on a basis which reasonably approximates the value, if any, of their interests, and the additional estimated value of such contribution;

COMMENTS

H.R. 32 allows participation by equity security holders who will make important future contributions. H.R. 31 adds partners of a debtor and an individual debtor. This "future contribution" doctrine sharply departs from the absolute priority rule of § 221(2) of the Bankruptcy Act. The Supreme Court decision in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939) is overruled. The proposed law follows the district court opinion in that case.